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## DO NATIONAL BANK EXAMINERS EXAMINE?\*

BY THE HON. THOMAS L. JAMES, PRESIDENT OF THE LINCOLN  
NATIONAL BANK, NEW YORK

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IT has sometimes occurred to those who read the newspaper reports of the failure of national banks and the consequent suffering of depositors and stockholders, that there must be some defect, either in the method of bank examination, or in the system itself. Sometimes there comes a sudden revelation of financial dishonesty which has practically cut a bank out of all its resources, impaired its capital, and left nothing for the depositors except trivial assets. Only those who hold the notes of the bank are protected, through the perfect operation of the National Banking Act. The wonder is, how, if a bank examiner does his duty, it is possible for a series of acts, either criminal or careless, or consequent upon bad judgment, to have been continued long enough to destroy an institution which obtains its charter from the Federal Government, and is under its supervision.

It should be remembered, however, that a rule is sometimes, with reference to its efficiency and value, to be determined by the exceptions which are found in its operation ; and, even in this superficial view, there is nothing in the entire record of the supervision of national banks, in the thirty-five years since the system was adopted, which does not justify the principle and the methods that have characterized the federal department which has the supervision of the national banking as its responsibility.

The official head, so far as the Government is concerned, of the national banking system of the United States, is the Comptroller of the Currency. While his powers, generally, are limited under the statutes, still they are ample enough to treat such emer-

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gencies as may not be provided for in the statutes. It is for him to say whether the hundreds of millions of deposits placed with the utmost confidence in the national banks are perfectly protected ; if not, what measures the Government shall take to give the depositors all that may be obtained for them, and to prevent further losses. In order to do this, the Comptroller of the Currency must have the assistance of a large number of trained, prudent, impartial, clear-headed men. It is upon their reports that he depends for information ; it is upon their examinations that he takes such action as the law prescribes, or as, within the discretion which is allowed him, he may deem prudent.

The national bank examiner is generally selected with a view to his experience as a banker ; but, always his character, his capacity to conduct rigid investigation uninfluenced by friendship or enmity, and to make faithfully accurate reports to his superior at Washington, are essential qualifications. It may be said that, if he has these qualities and thoroughly does his duty, no national bank ought ever to reach such a precarious condition as to justify the interference of the Government.

But, in the first place, it should be remembered that the business of banking goes on from day to day, from week to week and from year to year, and that, in the conduct of that business, the Government places, and ought to place, reliance in the integrity and ability, not only of its managing officers, but of its directors. The officers are engaged in their duties every day. In the banking business, as in every other business, all depends upon faith, confidence and judgment ; and, as no human judgment is infallible, it is not to be expected that the opinion, even of the astutest financier, can always be correct with reference to credit, value of property, or the advisability of making loans. At least once a week in the larger cities, and certainly at frequent intervals everywhere, the directors meet. They are required to have accurate information and report from the officers, upon the business done, upon the resources, upon the profits or losses, and to pass judgment upon them. Necessarily, upon this direction the Government must rely for a part of the time ; for it would be impossible to keep a national bank examiner busy with daily or even weekly examination, into the condition of one bank.

The examiner, having been appointed, has authority over a certain district. Where the business is large, as in the greater

cities of the United States, the examiner's jurisdiction usually is confined to a compact district. Where the banking business is widely scattered, his field covers a large territory; but it is the design of the Government, as it was of those who drafted the National Banking Act, that a bank examiner should have no greater territory or number of banks than would make it possible for him to conduct his examinations with the frequency that seems requisite; and the result of the experience of bank examiners is that semi-annual examinations will meet all requirements. So, throughout the country, these investigations into the condition of the national banks are now made twice a year; although, formerly, the banks of the larger cities, such as New York, Boston, Philadelphia, Baltimore and Chicago, were examined but once each twelvemonth. Congress, adopting the reasonable rule followed by many of the more important corporations of the United States, made it imperative that there should be critical outside inspection of the condition of the banks, at least once in every year. That is the system pursued by many corporations. Some are in the habit of calling in expert accountants or professional auditors, that they may obtain from them an accurate, impartial opinion as to the precise condition of the corporation.

One would think it impossible that anything short of absolute, intentional, deliberate dishonesty could so impair the resources of a national bank, between one examination and another in six months' time, as to render ineffective the system of examination pursued; but the fact that ruinous transactions have found their origin and attained their full growth within the space of a few months—yes, and within a few weeks—demonstrates the practicability of such perversion of a bank's funds. It is well known in banking circles that distress and difficulties come to banks, not wholly as a result of one single transaction—excepting, possibly, in times of panic, when all must stand or fall together—but as the culmination of a long series of mistakes of judgment, of careless acts, of criminal dishonesty, or, what often happens, the unexpected failure of a house or corporation of high credit. Dishonor of that kind is necessarily, in each case, comparatively small; otherwise, unless the entire officers and directors of a bank are engaged in it, it would be instantly discovered.

It is often asked: What are the duties of the bank examiner? But any man of business experience ought to be able to answer

that question, without referring to the National Banking Act or inquiring of the Comptroller of the Currency. The technical method, however, of carrying out these duties may not be so well understood. The examiner is expected to, and, unless he be a dishonest man, always does, appear at the bank which he purposes to examine, without having made any preliminary announcement of his purpose. The bank is not prepared for him ; he catches the officers and employees exactly as they are ; there can be no "best dress" put on for the occasion ; there can be no "fixing" of books or "temporary loans." Invariably, the president, cashier and other officers find the examiner and his assistants at the bank on their arrival there at the opening of business in the morning ; and I may say in passing that it is only in the larger cities, such as those before named, where the banking facilities are large and numerous, that assistants are employed by the bank examiner. The examiner of a district comprising the small cities and towns, does the work unaided. This, of course, is not practicable in a city like New York, for, were the examiner required to conduct the examination without assistance, it would entail the entire suspension of the bank's business, perhaps, for many days.

First of all, the assistant examiners take charge of the paying and receiving tellers' departments and count the cash, the chief examiner himself taking up the loans, securities, etc., in the custody of the cashier, and examining the same. The counting of the cash in the hands of the tellers may be an operation involving long and tedious work ; it depends upon the amount of cash and the shape it is in. That is the basis. After the chief completes his examination of the securities in the cashier's keeping, he puts himself in communication with the general bookkeeper, whose department is the vital nerve, so far as the record of the business of the bank is concerned. That is the starting point. There he obtains the report of the loans and discounts. Thus informed, he examines the notes, and the collateral or indorsers. Having verified these securities and their totals and having passed upon the credit behind time paper, he next takes the daily "proof" from the general bookkeeper, examines each item and substantiates it. It is the rule for the examiner to direct his assistants to make an examination of the individual ledgers ; in fact, following the system pursued by expert accountants. If the business of the bank has been honestly conducted, and if an expert

accountant who is a master in concealing dishonest transactions has not manipulated the books, this examination will reveal with absolute accuracy the condition of the bank.

Faith is, after all, the basis of banking ; and, if there be no faith, there can be no banking. For that reason, it is possible for those who are skilled in bookkeeping, but who are dishonest, to carry on, sometimes for a series of months or even years, dishonest methods by which even the most expert accountants are deceived, and can be deceived as long as this dishonest man can have access to the books. The recent record of embarrassments or failures has, in almost every instance, made clear, upon examination, that dishonest methods of this kind were carried on by those who had daily access to the books ; in one case, for a period covering at least fifteen years. In that case, the dishonest employee, knowing that his safety depended upon his ability to reach the books, refused to take a vacation. If the officers of the bank are unable to detect dishonesty of this kind—even if they adopted the most approved and scientific method of bookkeeping—it is beyond reason to expect that a national bank examiner can do it.

An anecdote may, perhaps, best illustrate this statement. At a time when there had been in one of our largest cities a startling revelation of a long series of dishonest acts committed by one of the most trusted of employees, the president of another bank stated with absolute confidence that he had perfected a system of bookkeeping, consisting of checks and counter checks so delicately adjusted as to instantly reveal any dishonest conduct or any mistake. He said to friends that there could be no embezzlement, misappropriation or breach of trust in his bank, without detection in twenty-four hours. Yet, within a month after he made this confident announcement, it was accidentally discovered that one of his employees had been misappropriating funds for nearly two years, taking in all some thirty or forty thousand dollars. After all, this only goes to show that “eternal vigilance alone is the price of safety.”

The best that bank officers can do is to adopt reasonable, thorough and competent bookkeeping methods ; and, after that, they must rely upon the faith which they repose in their employees. There is now in vogue in many of the larger banks a method of keeping books, the tendency of which is to prevent the continued falsification of entries—and it has been found to

be very effective—and that is the transfer of bookkeepers from ledger to ledger, at irregular intervals, and comparison of the pass books with the ledgers, by individuals other than those making the records. Under this system, the bookkeeper not knowing when or by whom he is to be succeeded, there is little probability of any attempt at collusion.

It follows, of course, that a bank examiner has, so far as the ascertainment of liability is concerned, to rely upon the machinery of the bank as he finds it. He can only observe and recommend methods, and, if need be, insist upon their adoption.

Experience, not only in national banking, but in all banking except that of the “wild cat” order, has shown that peril to banks comes from three directions. One is that which panic creates. A panic is a financial tornado. But few institutions can resist its tremendous fury. It will tear down many solvent banking institutions, as the tornado destroys whole cities and devastates wide districts. Its coming is sudden and unexpected. The only safety for a banking community at any time is in “union, which is strength ;” and this strength is called upon in a day of sudden financial violence. Thus, in the city of New York, at the time of that needless and senseless panic of 1893, it was the bold and defiant way in which such bankers as Frederic D. Tappen, Henry W. Cannon, George G. Williams, A. B. Hepburn, William A. Nash and J. Edward Simmons, representing the associated banks of New York, met the storm, that prevented widespread calamity. Mr. Tappen, as chairman of the appropriate committee, sat in the office of the Clearing House for many days, receiving in trust the securities of the banks of the association, and issuing the Clearing House certificates for which those securities were held as collateral, the certificates being then, so far as the Clearing House was concerned, legal tender for the payment of the debts of the banks to it. He issued, in this manner, nearly fifty millions of certificates, and thus protected the entire business community of the United States, and held that panic at arm’s length, until the fears of the people had subsided. I may be permitted to say here, that due justice has never been rendered Mr. Tappen and his associates for the dauntless courage and the inestimable services which the overthrow of that panic involved.

A national bank examiner could not have protected the depositors of a national bank in a crisis like that, nor could any

system have been devised which would have given depositors in that, or any other time of panic, absolute assurance of safety.

The other causes of danger to national banks, or any banks, are those which carelessness or error of judgment may involve. The national bank examiner, however, has no authority, with respect to the judgment of the officers and directors of a national bank. He cannot tell them, "you must not loan to this man, or upon these securities," because that is beyond his power. He is not responsible for the management of the bank; nor would it be possible to so extend the powers of a national bank examiner as to give him this authority; for, to do that would make an irresponsible and outside official really the manager of the business of the bank. His function is to determine, after the bank has acted, the character and value of the securities and the indorsements, upon the credit of which money is loaned. That involves judgment on his part just as much as it involves judgment on the part of the officers of the bank. He may be in error as to the value of securities, or as to the credit of a maker or endorser of a note. He can, however, determine whether a security is a quick asset or not; and he knows, as soon as he makes his examination, whether a loan is a loss or not. If he discovers that a large number of loans are dead losses, or that the value of securities upon which loans have been made has seriously depreciated after hypothecation, then it is his duty to determine whether the aggregate losses reach or exceed the capital and resources of the bank. If the loss affects only the surplus or the profits, he can do no more than report the fact to the Comptroller of the Currency; but, if the losses show serious impairment of the capital, the Comptroller of the Currency must act instantly, so that there may be no further impairment, and that what is left may be saved.

Sometimes the judgment of the examiner is relied upon by the Comptroller of the Currency, so that the harsher measures are not taken, but opportunity is given to the stockholders, either by reduction of capital or by making good its impairment in other ways, to place the institution upon a sound financial basis; and this is almost always done without any publicity. A public report of a condition which would require vigorous action on the part of the Comptroller of the Currency would instantly affect the credit of the bank, and would be sure to result in swift withdrawals by depositors, which would make it impossible for the bank to pro-



tect itself. It is not uncommon for the bank examiner to advise the officers of a bank regarding discounted paper, of the character of which he has been enabled to secure information, or of which he is in doubt, thus enabling the officers of the bank immediately to protect themselves. He does it usually by giving a hint, or by asking "if there is not a good deal of this paper out," or by saying that he wonders why "so and so" is asking for so much discount nowadays.

He is able sometimes to give information respecting the character of securities which it would have been impossible for the officers of the bank to obtain ; and his suggestions, in many ways, are of the highest value to the officers of the bank which he at the moment may be examining. This brings me to what I regard as the most important service rendered by the national bank examiners, a service which thoroughly vindicates the system and justifies the framers of the National Banking Act in providing for this method of examination. The public hears now and then of the failure, through dishonesty or misfortune, of a national bank. The disposition is to wonder how it could have happened that a bank should have been so long rotten, notwithstanding the examinations of the examiner. Earlier in this article, it is in some measure explained how a condition of that kind could exist ; but it should be remembered that the isolated cases—one here, one there—aggregating in the course of a year a remarkably small percentage of the national banks of the United States, have come in spite of the most approved methods of bank examination, often in spite of the vigilance of the president, cashier and directors. While the public hears of these things, it rarely hears of other services done by the national bank examiners, which has prevented failure after failure, or wreckage after wreckage. The examiner discovers a little weakness here or there ; he reports it to the Comptroller and to the officers of the bank. The weak spot is immediately strengthened. He finds that even the capital of a bank may be slightly impaired. It would be within the authority of the Comptroller immediately to close the bank. But, after a thorough examination, it may be deemed best not to do so drastic a thing as that, but to give an opportunity to the stockholders to strengthen the resources, to make good the capital ; and, when that is done, the bank goes on, having the value of the experience.

If the story of such services could be told, the people would perceive the strength of the system, and the supreme service it has rendered to the millions of depositors who have taken advantage of the national bank. Since the national banking system was established, the deposits in the banks have reached figures almost beyond the power of the mathematician to appreciate. The losses occasioned by the failure of banks, in comparison with the immense total of deposits, have been almost inappreciable. Not a dollar of the hundreds of millions of national bank notes that have been issued has been lost through the failure of any bank. Of course, that is simply a perfect record; and it is perfect, because the Government guarantees to the holders of those notes that they will be paid, and retains in its hands the Government securities which the banks purchase and upon which the notes are predicated. The Government cannot guarantee to every depositor that his deposit will be paid back to him; but it assures the depositor that, so far as inspiration, examination and authority of the National Banking Act go, it will do its best to protect him in his deposits; and it is safe to say that in the services thus rendered silently, unknown to the public, it has secured hundreds of millions of dollars by means of the energy, faithfulness, shrewdness and justness of the national bank examiners.

It is a singularly fortunate fact that, during the entire period of business strain and financial anxiety which has been over the American people in recent years, the Government has had, as bank examiners in the district of New York such men as Valentine P. Snyder, now first vice-president of the Western National Bank; the Hon. A. B. Hepburn, who went from the bank examiner's post to that of Comptroller of the Currency, returning to New York as a bank president, and the present bank examiner, William H. Kimball. New York being the financial heart of the nation, and the Association of the National Banks of New York being the vital nerve, not only of this city, but of the country as well, the services of a national bank examiner here entail not only great industry, but thorough knowledge of banking and wise judgment. These gentlemen have fully met all these requirements; and this community owes them a debt of gratitude. In all this period of stress and strain, there was no serious national bank failure.

THOMAS L. JAMES.